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FM AMEMBASSY BRASILIA

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C O N F I D E N T I A L BRASILIA 1678

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FOR RYAN/ARA

E.O. 11652: GDS

TAGS: EFIN; EINV; EGEN;

SUBJECT: WORLD BANK MATTERS RAISED IN BRASILIA

REF: SECTO 04074

1. REFTEL SUGGESTS EMBASSY COMMENTS ON THE TWO ITEMS IN PARA 1. WE WILL COMMENT SEPARATELY ON THE CARAJAS PROJECT AND THE GOB'S INTEREST IN CONTINUED WORLD BANK FINANCING FOR HYDOR-ELECTRIC POWER PROJECTS.

2. THE CARAJAS PROJECT.

A. BACKGROUND. CARAJAS, AS THE DEPARTMENT KNOWS, IS THE MOST IMPORTANT OF BRAZIL'S PROPOSED NEW IRON ORE PROJECTS. IT WILL BE A MAJORITY BRAZILIAN-OWNED JOINT VENTURE WITH US STEEL AND OTHER FOREIGN PARTNERS. CARAJAS HAS AN ESTIMATED 16 BILLION TONS OF VERY HIGH QUALITY IRON ORE, WITH SOME ESTIMATES RANGING CONSIDERABLY HIGHER. BRAZIL HOPES THE PROJECT WILL MAKE BRAZIL THE WORLD'S LARGEST IRON ORE EXPORTER.

3. THE BRAZILIAN STATE COMPANY, CVRD, AND US STEEL HAVE HAD STRONG DIFFERENCES, HOWEVER, ABOUT KEY MANAGEMENT AND FINANCIAL ISSUES. US STEEL WANTS
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ENOUGH MANAGEMENT AND FINANCIAL CONTROL TO PROTECT

ITS INVESTMENT AND SEE THAT CARAJAS IS RUN EFFICIENTLY. MINISTER UEKI, IN RESPONSE TO A QUESTION FROM THE AMBASSADOR, SAID LAST WEEK THAT THE DIFFICULTIES BETWEEN US STEEL AND CVRD HAD BEEN SOLVED. GIVEN THE IMPORTANCE OF THIS PROJECT AND THE MAGNITUDE OF THE US COMMERCIAL INTERESTS AT STAKE, THE DEPARTMENT MAY WISH TO CHECK WITH US STEEL FOR A READING ON THE STATUS OF THE NEGOTIATIONS AS VIEWED FROM PITTSBURGH. CONTINUING DIFFICULTIES BETWEEN US STEEL AND CVRD COULD EVIDENTLY AFFECT THE POSSIBILITIES OF EXIM FINANCING. HOWEVER, IN A MEETING TODAY, FEBRUARY 24, MINES AND ENERGY OFFICIALS AGAIN EMPHORIZED THAT IN THEIR VIEW THEIR DIFFICULTIES WITH US STEEL WERE LARGELY RESOLVED. ON THE OTHER HAND, CURRENT PLANS APPARENTLY STILL ENVISAGE REDUCTION OF US STEEL'S PARTICIPATION TO 25 PERCENT AND THE ADMISSION OF BRITISH, JAPANESE, AND SPANISH INTERESTS, THE PLAN WHICH ORIGINALLY RAISED THE PROBLEMS OF MANAGEMENT CONTROL.

4. CONCERNING FINANCING, CVRO'S LATEST PLANNING FIGURES ENVISAGE A TOTAL INVESTMENT COST OF \$2,152 MILLION PLUS REINVESTMENT OF PROFITS WHICH WILL BRING FINAL TOTAL UP TO \$2.7 BILLION. OF THIS, \$736 MILLION WOULD BE PUT UP FROM BRAZILIAN SOURCES. THE TOTAL CONTRIBUTION FROM NON-BRAZILIAN SOURCES WOULD BE \$1,416 MILLION, INCLUDING \$689 MILLION IN EQUITY AND LOAN CAPITAL FROM THE FOREIGN SHAREHOLDERS; FOR THE BALANCE, \$727 MILLION, CVRD AND THE MINISTRY OF MINES AND ENERGY HOPE EXTERNAL FINANCING CAN BE ARRANGED FROM SUCH SOURCES AS THE IBRD AND EX-IM. INTERNAL CVRD WORKING PAPERS ASSUME A WORLD BANK LOAN OF AT LEAST \$100 MILLION.

B. TALKING POINTS.

5. THE PRINCIPAL POINTS TO MAKE, WE BELIEVE, ARE:

(A) THE CENTRAL IMPORTANCE OF THIS PROJECT IN BRAZIL'S DEVELOPMENT EFFORT. IRON ORE IS ONE OF BRAZIL'S MAJOR PRIMARY PRODUCT EXPORTS, AND NOW APPROACHES
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COFFEE IN IMPORTANCE. CARAJAS THUS INVOLVES A KEY PROJECT IN BRAZIL'S EXPORT EXPANSION AND DIVERSIFICATION PROGRAM AND THEREBY ITS EFFORT TO OVERCOME THE EXTERNAL BALANCE OF PAYMENT CONSTRAINT TO RAPID GROWTH.

(B) FROM AITONG TERM STRATEGIC STANDPOINT THE CARAJAS IRON ORE SOURCE COULD BE IMPORTANT TO THE US. (IN HIS PRESENTATION TO THE SECRETARY,

UEKI NOTED THE VERY RAPID GROWTH OF IRON ORE EXPORTS TO THE US). WE BASICALLY SEE BRAZIL AS A RESPONSIBLE RELIABLE SUPPLIER OF INDUSTRIAL MATERIALS TO US AND OTHER INDUSTRIAL COUNTRIES.

(C) SUPPORT FOR THE CARAJAS COMPLEX ALSO IS IN LINE WITH US DESIRE FOR STEPPED-UP EFFORTS BY THE WORLD BANK AND ITS IFC AFFILIATE TO ENCOURAGE INVESTMENT IN MINERALS, A US PROPOSAL FIRST MADE BEFORE THE UN SPECIAL SESSION.

II. HYDROELECTRIC POWER FINANCING.

A. BACKGROUND.

6. SOURCES IN THE MINISTRY OF MINES AND ENERGY INFORM US THAT THE GOB IS CURRENTLY INTERESTED IN WORLD BANK FINANCING FOR POWER ON THE ORDER OF \$210 MILLION. THE PROJECTS WOULD BE IN THE NORTHEAST REGION, INCLUDING SOME OF BRASIL'S LEAST DEVELOPED AREAS, AS WELL AS FOR INTER-CONNECTIONS BETWEEN THE NORTHEAST-SOUTHEAST REGIONS. A PRINCIPAL INTEREST WOULD BE THE FINANCING OF DISTRIBUTION AND TRANSMISSION LINES. DESIRED NEW EX-IM FINANCING AMOUNTS TO \$100 MILLION, PRINCIPALLY FOR PROJECTS IN MINAS GERAIS, PARANA, AND MATTO GROSSO.

B. TALKING POINTS.

7. IN HIS COMMENTS, THE SECRETARY MAY WISH TO STRESS: -- BRAZIL'S VERY HEAVY EXTERNAL FINANCING REQUIREMENTS OVER THE NEXT SEVERAL YEARS; -- THE FACT THAT THE PROJECTS FOR WHICH WORLD BANK

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FINANCING IS DESIRED ARE IN SOME OF THE LEAST DEVELOPED REGIONS OF BRAZIL.

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